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Supreme Court, U.S.

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**In the Supreme Court of the United States**

OCTOBER TERM, 1986

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**JERSEY SHORE STATE BANK, PETITIONER**

*v.*

**UNITED STATES OF AMERICA**

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**ON WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE THIRD CIRCUIT**

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**BRIEF FOR THE UNITED STATES**

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### QUESTION PRESENTED

Section 3505 of the Internal Revenue Code provides that, where a lender furnishes funds directly or indirectly to an employer for the payment of wages, the lender in certain circumstances may be personally liable if the required employment taxes are not withheld from those wages and paid over to the IRS. The question presented is whether, as a prerequisite to the government's maintenance of a civil suit to collect the lender's personal liability in such circumstances, the IRS must have sent to the lender, within 60 days of making an assessment of the unpaid taxes against the employer, a copy of the tax bill that is required to be sent to the employer under Section 6303(a).

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**OPINIONS BELOW**

The opinion of the court of appeals (Pet. App. 1a-24a) is reported at 781 F.2d 974. The opinion of the district court (Pet. App. 27a-37a) is reported at 628 F. Supp. 15.

**JURISDICTION**

The judgment of the court of appeals was entered on January 10, 1986. A petition for rehearing was denied on February 4, 1986 (Pet. App. 25a-26a). The petition for a writ of certiorari was filed on April 22, 1986, and was granted on June 2, 1986. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

(1)

## STATUTES INVOLVED

The relevant portions of Sections 3505 and 6303 of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth at Pet. App. 50a-51a.

## STATEMENT

1. The Internal Revenue Code imposes a number of "employment taxes," set forth in Subtitle C of the Code. See I.R.C. §§ 3101-3510.<sup>1</sup> These taxes include the social security or FICA tax (I.R.C. §§ 3101-3126) and the income taxes that are withheld from employees' wages at the source (I.R.C. §§ 3401-3406).<sup>2</sup> The social security tax is imposed on the employer and the employee alike, with each being required to pay roughly half the overall tax. See I.R.C. §§ 3101 and 3111. The withheld income tax, representing a current payment on account of the employee's annual liability, is of course borne solely by the employee. See I.R.C. §§ 3401 and 3402.

Subtitle C places two basic obligations on employers with respect to these taxes. The employer is required to pay the employment taxes imposed directly on him, such as his share of the social security tax. See I.R.C. § 3111. The employer is also required to withhold from his employees' wages, and pay over to the IRS, the employment taxes that are imposed on the employees, such as the withheld income tax and the employees' share of the social security tax. See

<sup>1</sup> Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

<sup>2</sup> Other Subtitle C taxes, such as the Federal Unemployment Tax (I.R.C. §§ 3301-3311) and the Railroad Retirement Tax (I.R.C. §§ 3201-3233), are not involved here.

I.R.C. §§ 3102(a) and (b), 3403, 3501. These latter taxes are usually called "withholding taxes." The employer in essence serves as a collection agent for the government with respect to these amounts; after collecting the taxes from the employees' salaries, the employer is required to hold those sums in trust for the government until they are paid into the Treasury at designated times. See I.R.C. §§ 3102(a) and (b), 3403, 3501(a), 7501.

If an employer fails to satisfy its obligations with respect to withholding taxes, the Code provides several alternatives that the IRS may use to collect such funds. The Commissioner of course may collect withholding taxes directly from the employer, who is explicitly made liable therefor. See I.R.C. §§ 3102(b), 3403. In recognition of the special "trust fund" status of withholding taxes, however, the Code affords the Commissioner a number of particularized collection remedies. One of these is set forth in Section 6672, the so-called "responsible officer" provision. Under that provision, corporate officers or other persons responsible for the collection and payment of withholding taxes incur a personal liability, in the form of a penalty equal to 100% of the unpaid taxes, if they willfully fail to satisfy those responsibilities. See I.R.C. § 6672(a).

Another remedy for collecting unpaid withholding taxes is set forth in Section 3505. Under Section 3505(a), "a lender, surety, or other person" who pays wages directly to the employees of another employer is "liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld from such wages." A lender or other third party is also subject to such personal liability if it supplies

funds to an employer for the specific purpose of paying wages "with actual notice or knowledge \* \* \* that such employer does not intend to or will not be able to make timely payment or deposit" of the requisite withholding taxes (I.R.C. § 3505(b)). In the latter case, the third party's liability is limited to 25% of the aggregate amount that it supplied to the employer (*ibid.*). Section 3505 was enacted by Congress to discourage a practice known as "net payroll financing," under which lenders who undertook to satisfy an employer's payroll obligations would supply funds necessary to meet only the net amounts due to the employees, and no one would pay over the withholding taxes due to the government. See H.R. Rep. 1884, 89th Cong., 2d Sess. 20 (1966); S. Rep. 1708, 89th Cong., 2d Sess. 21-22 (1966).

2. Petitioner is a bank with its principal place of business in Jersey Shore, Pennsylvania (Pet. App. 28a). Beginning in early 1976, petitioner provided a total of approximately \$290,000 to finance the operations of Pennmount Industries, Inc., a financially troubled company engaged in the business of manufacturing furniture. From the fourth quarter of 1977 through the first quarter of 1980, Pennmount failed to pay over to the IRS the income and social security taxes withheld from its employees' wages. Pennmount also failed to pay the employer's portion of social security taxes that it owed (Pet. App. 28a). The Commissioner made an assessment against Pennmount for each of these 10 quarterly periods, as well as other quarters not involved here.<sup>3</sup> These assess-

<sup>3</sup> An "assessment" is the recording by the Internal Revenue Service on its books of the taxpayer's liability for taxes. See I.R.C. § 6203. It is a statutory prerequisite to summary collection methods such as levy and distraint. See I.R.C. § 6331.

ments reflected Pennmount's liability for the various unpaid employment taxes (*id.* at 39a, 43a-45a).

Section 6303(a) of the Code provides that the Commissioner, as soon as practicable after making a tax assessment, and in any event within 60 days of making an assessment, must "give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof." The Commissioner typically provides such notice by sending the taxpayer a "Request for Payment of Balance Due"—in essence, a tax bill—notifying the taxpayer of the amount owed and requesting payment within 10 days. See M. Saltzman, *IRS Practice and Procedure* ¶ 14.03, at 14-11 *et seq.* (1981). On the same day that the Commissioner made each of the assessments against Pennmount, he sent Pennmount a notice pursuant to Section 6303(a) stating the amount of its unpaid employment taxes and demanding payment thereof (Pet. App. 43a-45a). In each instance, Pennmount failed to pay, in whole or in part, the assessed taxes. The total unpaid balance of the assessments is approximately \$116,000, plus interest (*id.* at 39a).

3. On December 30, 1983, the United States brought this action against petitioner in the United States District Court for the Middle District of Pennsylvania (Pet. App. 27a-28a). The government alleged that petitioner, beginning in October 1977, had lent funds to Pennmount under circumstances that rendered petitioner personally liable, under Section 3505 of the Code, in an amount equal to a portion of the employment taxes assessed against Pennmount (Pet. App. 2a, 38a-41a). Specifically, the government alleged (*id.* at 39a) that petitioner had "paid wages directly to Pennmount employees," thereby making it liable under Section 3505(a) for the full amount

of the unpaid withholding taxes. Alternatively, the government alleged (Pet. App. 40a-41a) that petitioner had supplied funds to Pennmount "for the specific purpose of paying \* \* \* wages," with knowledge that Pennmount "did not intend or would not be able to make timely payments or deposits of the \* \* \* taxes required to be deducted and withheld" from its employees' wages, thereby making petitioner liable under Section 3505(b) for the amount of unpaid withholding taxes up to 25% of the amount of funds supplied. The government alleged that petitioner's liability under Section 3505(a) was approximately \$76,500, plus interest, and that its alternative liability under Section 3505(b) was approximately \$72,000, plus interest (Pet. App. 2a, 40a-41a). In its answer, petitioner admitted making commercial loans to Pennmount, but denied any liability under Section 3505 (Pet. App. 3a, 46a-49a).

The government moved for summary judgment with regard to petitioner's liability under Section 3505(a) (Pet. App. 31a). Petitioner conceded liability under Section 3505(a) for the period from January 1979 through March 1980, but opposed summary judgment with respect to the earlier periods (Pet. App. 29a). Petitioner filed a cross-motion for summary judgment, however, contending that the United States was precluded from suing it for any of the periods in question because the Commissioner had not provided it with notice of the tax assessments against Pennmount within the 60-day period specified in Section 6303(a). Petitioner submitted that, if the instant suit were successful, it would be a "person liable for the unpaid tax" within the meaning of Section 6303(a). Petitioner accordingly argued that the Commissioner was required, within 60 days of

making the assessments against Pennmount, to send petitioner as well as Pennmount notice of the assessments in the form of the tax bill described in Section 6303(a) (Pet. App. 32a-33a; J.A. 8-9).

The district court granted petitioner's cross-motion for summary judgment (Pet. App. 27a-36a). Relying on *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983), the district court held that the notice and demand for payment specified in Section 6303(a) must timely be sent, not only to the taxpayer against whom the taxes in question have actually been assessed, but also to third parties against whom the United States might in future seek to establish liability in a civil suit under Section 3505 (Pet. App. 33a-35a). Because the government conceded that it had not notified petitioner of the assessments against Pennmount prior to the commencement of the instant suit on December 30, 1983 (*id.* at 32a), the district court held that the government's suit was barred (*id.* at 35a-36a).

4. The court of appeals reversed, one judge dissenting (Pet. App. 1a-24a). The court rejected petitioner's argument that the "plain meaning" of Section 6303(a) entitled it to receive notice of the assessment against Pennmount at the time Pennmount's taxes were assessed. Section 6303(a) speaks of "notice to each person liable for the unpaid tax"; at the time of the assessment against Pennmount, the court of appeals observed, Pennmount's lenders had only a "potential liability" with respect to the unpaid tax (Pet. App. 9a). The court also emphasized that Section 6303(a) "requires notice of a particular kind: i.e., 'one stating the amount and demanding payment thereof'" (Pet. App. 8a (emphasis in original)). The court pointed out that the notice of assessment

against the employer typically is not restricted to unpaid withholding taxes, but includes other amounts for which lenders under Section 3505 are not liable; thus, the tax bill sent to the employer would only fortuitously "stat[e] the amount" of the lender's potential liability. Pet. App. 9a (citing I.R.C. § 6303(a)). Moreover, notice to a lender that the IRS has assessed taxes against the employer would not "demand payment" from the lender, since the lender would not be expected to pay, and could not be required to pay, the tax at that time (Pet. App. 9a-10a). The court of appeals therefore found "the government's construction of the statute the more natural and logical reading of the language: i.e., section 6303(a) requires notice only to those individuals against whom the taxes have been assessed" (Pet. App. 10a).

The court then explained that its reading of Section 6303(a) served the evident purpose of the statute's notice requirement (Pet. App. 11a-17a). The Code provides two distinct methods for the collection of taxes: (1) by administrative means, such as levy and distraint, following an assessment; and (2) by means of a civil suit. In the case of administrative collection, the court observed, "the need for the notice provided by section 6303(a) and its predecessor statutes is readily apparent," since, upon assessment and demand, all of the taxpayer's property becomes subject to a tax lien and to summary collection by levy or seizure. Pet. App. 11a-12a (citing I.R.C. §§ 6321 and 6331). The notice provided under Section 6303(a) thus protects the taxpayer by giving him the opportunity, by promptly paying the assessed tax, to take steps to avoid the possibility of a levy on his property. Under Section 3505, however, the government cannot

collect the tax administratively, but must proceed by a civil suit, so that the third party is in no danger of having his property seized to satisfy the obligation. In such circumstances, "service of the government's complaint provides the party with all the notice and protection required" (Pet. App. 13a).

The court also observed that the notice sought by petitioner would "serve[] no useful purpose" but would simply interpose a "formalistic requirement" on which lenders might rely to "thwart[] Congress' intent to recover the unpaid withholding taxes" from them (Pet. App. 18a). The court rejected as "unfounded" (*ibid.*) the concern that lenders might be prejudiced absent such notice because they might not otherwise suspect that they ran the risk of Section 3505 liability. The court explained that Section 3505 requires the government to prove that the lender was "actually or constructively aware of its potential liability for the taxes" at the time it advanced funds to the financially distressed employer (Pet. App. 18a (emphasis omitted)). Thus, the Section 6303(a) notice would "communicate[] no additional information" to the lender because it would tell him nothing that he did not already know (Pet. App. 18a). Finally, the court of appeals emphasized that requiring the IRS to notify lenders under Section 6303(a) "would impose a prohibitory investigative burden on the government" (Pet. App. 20a) that would render Section 3505 "a substantial nullity" (Pet. App. 21a).

Judge Weis dissented (Pet. App. 21a-24a). In his view, the plain language of Section 6303(a) required that notice be given to the lender. He acknowledged that the reasons advanced by the government for its reading of the statute "have some logic and would possibly ease administrative burdens on the govern-

ment" (*id.* at 22a), but he believed that those arguments should be addressed to Congress, not the courts.

#### INTRODUCTION AND SUMMARY OF ARGUMENT

Congress enacted Section 3505 in 1966 (Federal Tax Lien Act of 1966, Pub. L. No. 89-719, § 105(a), 80 Stat. 1138) in response to a practice generally known as "net payroll financing," which was especially common in the case of employers experiencing financial difficulties. H.R. Rep. 1884, *supra*, at 20; S. Rep. 1708, *supra*, at 21-22. Under that practice, a third party—typically a surety, bank, or general contractor—would supply the employer with funds for the payment of wages, or pay wages directly to the employees, thereby keeping the employer afloat. In order to limit its own exposure, however, the lender would supply an amount equal only to the "net," or after-tax, wages due the employees, without paying, "either to the employees or to the Government, the withholding taxes due the Government." H.R. Rep. 1884, *supra*, at 20; S. Rep. 1708, *supra*, at 21. See *United States v. Coconut Grove Bank*, 545 F.2d 502, 505 (5th Cir. 1977); *United States v. Algernon Blair, Inc.*, 441 F.2d 1379, 1381 (5th Cir. 1971). Employees receiving such "net wages" were entitled (then as now) to a credit against their own tax liabilities for the taxes required to be withheld, regardless of whether the employer actually paid the taxes over to the United States. See 26 U.S.C. (1964 ed.) 31(a).

Although employers in such circumstances technically remained liable for the unpaid withholding taxes, Congress found that they were "likely to be without financial resources and, as a result, [that] recourse against them [might] well be fruitless."

H.R. Rep. 1884, *supra*, at 20; S. Rep. 1708, *supra*, at 21. Under pre-1966 law, moreover, recourse could not be had against the lender either, because the lender ordinarily would not have been deemed to be an "employer," as defined by statute, with respect to the withholding taxes. *Ibid.* Congress in 1966 acted to stem the resulting loss of revenue by addressing this latter problem directly. It enacted Section 3505 to impose personal liability upon third-party lenders who engage in net payroll financing, concluding that such lenders "sit in essentially the same position vis-a-vis control over payroll funds and access to information as the employer itself" (Pet. App. 6a). See H.R. Rep. 1884, *supra*, at 20; S. Rep. 1708, *supra*, at 22.

Petitioner concedes that it engaged in net payroll financing and that it is liable under Section 3505 for at least part of Pennmount's unpaid withholding taxes. Petitioner contends, however, that the government is barred from suing to collect this Section 3505 liability because the Commissioner failed to send it a copy of the tax bill that was sent to Pennmount at the time Pennmount's taxes were assessed. There is a split in the circuits on the question whether the notice specified in Section 6303(a) must be sent to lenders in such circumstances. Compare *United States v. Messina Builders & Contractors Co.*, No. 85-2505 (8th Cir. Sept. 23, 1986) (notice required), *United States v. Merchants Nat'l Bank*, 772 F.2d 1522 (11th Cir. 1985), petition for cert. pending, No. 85-1480 (same), and *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983) (same), with *United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d 1436 (9th Cir. 1986), petition for cert. pending, No. 86-209 (notice not required).

The Third Circuit below correctly held that Section 6303(a) does not require notice to lenders of the assessment against the employer, and that the Commissioner's failure to provide such notice in any event does not prevent the United States from bringing a civil action against the lender under Section 3505. The terms of Section 3505 impose upon a lender not a liability for a tax, which could be collected administratively, but rather a liability "in a sum equal to the taxes" required to be withheld from the employees' wages—a personal liability that can be collected only by a civil suit instituted by the Department of Justice. See I.R.C. §§ 3505(a) and (b), 7401; H.R. Rep. 1884, *supra*, at 65-66. Adoption of the notice requirement that petitioner seeks would lead to an irrational result, for it would require the IRS, when making an assessment against a taxpayer, to notify a group of third parties whose identities the IRS typically would not know at the time. This notice would take the form of a tax bill that those parties would not then be expected to pay, and that bill would be in an amount that would rarely if ever correspond to any liability that the government might seek to impose in a future Section 3505 civil suit. If petitioner's contention were accepted, it would place such an enormous administrative burden on the government as a precondition to imposing Section 3505 liability that the provision would be nullified as a practical matter, with attendant frustration of Congress's goal to eradicate the practice of net payroll financing. And this untoward result would yield no countervailing benefits—other than windfalls to culpable lenders—because the notice petitioner seeks would be an empty formality that would convey no useful information to potentially liable third parties.

Petitioner's argument for this perverse result is grounded exclusively in a distorted reading of the text of Section 6303(a). A careful reading of that statute, however, coupled with consideration of its legislative history and underlying purposes, confirms the court of appeals' conclusion that Section 6303(a) requires notice only to the taxpayer or taxpayers against whom the assessment is made, and not to third parties who might have a liability (under Section 3505 or otherwise) for all or part of the amounts assessed. Petitioner's contention, finally, is directly contrary to the well-settled proposition that a notice of assessment is not a prerequisite to a civil suit by the United States to recover unpaid taxes.

#### ARGUMENT

##### **NOTICE TO A LENDER OF AN ASSESSMENT OF DELINQUENT EMPLOYMENT TAXES AGAINST AN EMPLOYER IS NOT REQUIRED BY SECTION 6303(a) AND IN ANY EVENT IS NOT A PREREQUISITE TO A SUIT TO COLLECT THE AMOUNT OF DELINQUENT WITHHOLDING TAXES FROM THE LENDER UNDER SECTION 3505**

##### **A. The Terms Of Section 6303(a) Do Not Require That A Notice Of The Assessment Against The Employer Be Furnished To All Third Parties Who Might Be Liable For Withholding Taxes Under Section 3505**

1. Petitioner's primary contention (Br. 7-10) is that the plain meaning of Section 6303(a) compels the conclusion that the Commissioner was required to give it notice of the assessment against Pennmount. As the court of appeals explained (Pet. App. 8a-10a), petitioner's argument is based on an incomplete and inaccurate reading of the statute. Section 6303(a) provides in pertinent part that the Commis-

sioner "shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to Section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof." In essence, Section 6303(a) requires the Commissioner to send to the taxpayer "a typical creditor's dunning letter" (Pet. App. 9a)—a tax bill demanding payment of a particular amount. See M. Saltzman, *supra*, ¶ 14.03, at 14-11 *et seq.* (reprinting sample IRS form letters).

Petitioner focuses exclusively on the portion of the statute requiring the Commissioner to give notice "to each person liable for the unpaid tax" and argues that, because the government is seeking to hold it liable in an amount equal to a portion of Pennmount's unpaid withholding taxes, it falls within this category and therefore must be given notice of the assessment of the tax delinquency. Examination of the complete text of Section 6303(a), however, demonstrates that this simplistic reading of the statute is erroneous. Section 6303(a) contemplates the giving of a particular form of notice—one "stating the amount [of the tax] and demanding payment thereof." The notice that petitioner contends must be sent to it (see Pet. Br. 5, 8, 24)—a copy of the tax bill that is being sent to the assessed employer—does not meet the statutory requirements. It neither sets forth the amount due from the third party nor demands payment of any tax by the third party. Accordingly, the "plain language" of the statute cannot be said to require that third parties potentially liable under Section 3505 be furnished with the notice of assessment mailed to the employer.

First, the notice of assessment sent to the employer only rarely, if ever, will set forth the amount

for which the third party is potentially liable. In almost every case, an employer who has not paid withholding taxes will not have paid the employer's portion of social security taxes either. See page 2, *supra*. The tax bill sent to the employer will demand payment of these latter taxes, but a lender can have no Section 3505 liability for them because they are obligations of the employer, not "taxes \* \* \* required to be deducted and withheld from [the employees'] wages" (I.R.C. § 3505(a) and (b)). See H.R. Rep. 1884, *supra*, at 21 (a lender "is not liable for the employer's portion of payroll taxes"). Accordingly, the amount of tax due stated in the notice of assessment will not reflect an amount for which the third party may be personally liable. Moreover, even with respect to the withholding taxes owed by the employer, the notice may not reflect the magnitude of the third party's exposure because its Section 3505 (b) liability is limited to 25% of the funds that it advanced to the employer, so that in many cases the lender will not be liable for the full amount of the unpaid withholding taxes. Finally, unless the time period in which the third party paid net wages or financed a net payroll coincides exactly with the time period reflected in the assessment against the employer, the third party's potential liability will not coincide with the employer's withholding-tax liability. Because the tax bill sent to the employer will thus only fortuitously reveal the amount for which the third party is potentially liable, this notice does not provide to the third party the sort of notice contemplated by Section 6303(a).

Second, a notice that demands that the employer promptly pay the assessed tax does not correspond-

ingly demand payment from a third party who receives a copy of the notice. At the time the assessment is made, the government is seeking to collect from the taxpayer-employer, not from the lender, and the notice gives no indication of the likelihood that the government will, at some future time, bring a suit to collect the third party's liability under Section 3505. See *United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d at 1439. Indeed, the Commissioner has no authority to "demand payment" from a third party when he makes an assessment against the employer; Congress has provided that a lender's liability under Section 3505 can be collected only in a civil suit instituted for that purpose by the Department of Justice. See I.R.C. §§ 7401, 7402. Thus, if one is "to give effect \* \* \* to every word Congress used" (*Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979)), it is manifest that the notification to third parties desired by petitioner is not required by Section 6303(a), since the tax bill sent to the employer under Section 6303(a) neither "stat[es] the amount" nor "demand[s] payment" of the third party's potential liability.

In fact, even if one focuses solely on the short phrase in Section 6303(a) on which petitioner relies—the requirement that notice be given "to each person liable for the unpaid tax"—the language does not unambiguously support petitioner's construction of the statute. At the time of the assessment against the employer, the employer's lenders, as opposed to the employer itself, have not a present but only a "potential liability" (Pet. App. 9a) to pay the unpaid tax. The employer is obviously a "person liable" for the unpaid tax because the tax has been assessed against it; that assessment has the force of a judg-

ment that may be summarily collected, and it is ripe for immediate payment. See I.R.C. § 6331. A lender in petitioner's position, by contrast, could become liable to make a payment on account of the employer's unpaid tax only if the United States subsequently brings a civil action in which the lender's Section 3505 liability is established, a step that it is the Commissioner's current practice to recommend only if he is unable to collect the withholding-tax delinquency from other sources (such as the employer itself or its responsible officers). The speculative nature at the time of assessment against the employer of the lender's ultimate obligation to pay is evident from IRS estimates that Section 3505 comes into play in only about one case for every 5,000 withholding-tax delinquencies. See page 47, *infra*. Thus, because the lender's liability in practical terms is highly contingent at the time the Section 6303(a) notice is mailed to the employer, it is difficult to describe the lender at that moment as a "person liable" for the unpaid tax.

Moreover, even if a lender in petitioner's position were thought to be a "person liable," such a third party, technically speaking, is not a person liable "for the unpaid tax" (I.R.C. § 6303(a)). Section 3505 provides that a third party in certain circumstances "shall be liable in his own person and estate \* \* \* in a sum equal to the taxes" specified therein; Section 3505 does not impose a tax or make the third party liable to pay another's tax. A third party sued under Section 3505 is subject to a distinct personal liability and hence is not literally a person liable "for the unpaid tax" that was assessed against the employer. See *United States v. Messina Builders & Contractors Co.*, slip op. 15 (Fairchild, J., dissenting). Finally, the phrase "the unpaid tax" as used

in Section 6303(a) obviously refers to the delinquent taxes specified in the notice of assessment. See I.R.C. § 6303(a), cross-referring to I.R.C. § 6203. As noted above, the third party will almost invariably not be potentially liable for the full amount stated in the notice of assessment. Rather, his exposure will be limited to an amount equal to a portion of "the unpaid tax."

In sum, the plain language of Section 6303(a) does not require that a notice of assessment against an employer be sent to a third party who might in future be held liable under Section 3505. Rather, as the court of appeals concluded (Pet. App. 10a), "the more natural and logical reading" of the statutory language is the construction that we urge—that Section 6303(a) "requires notice only to those individuals against whom the taxes have been assessed."<sup>4</sup>

2. The historical antecedents of Section 6303(a) support our view that its notice requirement contemplates notification to the party or parties against whom the assessment is made, not to third parties who in future may be held to have liability in an amount equal to some part of the unpaid taxes. The notice requirement historically has been linked to the assessment "list" that was compiled by the government. The current statute traces its origins back to

<sup>4</sup> It is noteworthy that Section 6303(a) has never been interpreted to require that "responsible officers" or other persons liable for a "penalty equal to the amount of the [delinquent withholding] tax" (I.R.C. § 6672) receive notice of the assessment against the employer. Because the Code specifies that the liability under Section 6672 is to be "assessed and collected in the same manner as taxes" (I.R.C. § 6671(a)), these responsible persons do receive a notice of assessment, but only when a separate assessment is made against them.

the Revised Statutes of 1878. Section 3182 of the Revised Statutes required the Commissioner to make assessments of unpaid taxes and to "certify a list of such assessments when made to the proper collectors." Section 3184 of the Revised Statutes required the collector, "within ten days after receiving any list of taxes from the Commissioner \* \* \* , [to] give notice to each person liable to pay any taxes stated therein, \* \* \* stating the amount of such taxes and demanding payment thereof." Similar provisions were contained in the Internal Revenue Code of 1939, ch. 2, §§ 3640, 3641, 3655, 53 Stat. 442, 446. Section 3640 empowered the Commissioner to make assessments, Section 3641 directed him to "certify a list of such assessments when made to the proper collectors," and Section 3655 required the collector to issue a notice and demand for payment to "each person liable to pay any taxes stated therein" within 10 days after receiving a list from the Commissioner.<sup>5</sup>

<sup>5</sup> While the Code today no longer provides for certification of an assessment list, the basic principles concerning the identity of persons against whom assessments are made remain unchanged from 1878. The assessment is made by "recording the liability of *the taxpayer*" (I.R.C. § 6203 (emphasis added)), and the regulations require that the record of assessment contain the identity "of *the taxpayer*" (Treas. Reg. § 301.6203-1 (emphasis added)). The taxpayer in this connection is the employer, the party against whom the assessment is made; a third-party lender potentially liable under Section 3505 does not come within the term "taxpayer" and cannot appear on the assessment list. See *United States v. Dixieline Financial, Inc.*, 594 F.2d 1311, 1313 (9th Cir. 1979). Like its predecessors, Section 6303(a) necessarily draws a nexus between the assessment list and the notice requirement because that notice requirement is triggered by the making of an assessment "pursuant to section 6203."

These predecessor statutes of Section 6303(a), which closely tracked the present language, clearly contemplated that notice would be sent only to those persons who appeared on the assessment list, *i.e.*, to "each person liable to pay any taxes stated therein" (Rev. Stat. § 3184; 53 Stat. 446). As we have shown above, a third party in petitioner's position is not a "person liable to pay" the tax stated in the notice of assessment sent to the employer. And there is no indication that Congress, in reformulating these earlier provisions as Section 6303(a) of the 1954 Code, intended to make any change in the identity of the persons covered by the notice provision. Indeed, the legislative history demonstrates that the contrary is true (see pages 29-32, *infra*).<sup>6</sup>

<sup>6</sup> Section 3505 of course had not been enacted at the time Congress reformulated the 1954 Code, and therefore Congress could not have been expected to address specifically in Section 6303 the possibility of giving notice to a third party potentially liable under Section 3505. But amicus First Alabama Bank is incorrect in stating (Br. 6) that there did not exist in 1954 any third-party liability that did not provide for separate notice and assessment. This Court had made clear in 1931 that the Commissioner could collect a transferee's liability by filing a lawsuit (*Phillips v. Commissioner*, 283 U.S. 589, 592 & n.2 (1931)), and, while the assessment of certain types of transferee liabilities was statutorily authorized (*e.g.*, Internal Revenue Code of 1939, ch. 2, § 311, 53 Stat. 90-91), transferee liabilities not covered by statute remained collectible only by civil action. Moreover, the government has always been empowered to collect delinquent taxes from a party that has contractually assumed the taxpayer's liability, even though it cannot assess the taxes against such a third party. See, *e.g.*, *United States v. Scott*, 167 F.2d 301 (8th Cir. 1948); cf. *United States v. John Barth Co.*, 279 U.S. 370 (1929) (suit against surety on taxpayer's bond to secure payment of taxes). Thus, there did exist in 1954 third-

**B. The Policies Underlying Section 6303(a) Are Not Served By Construing It To Require Notice To Third Parties Potentially Liable Under Section 3505**

The Internal Revenue Code provides several distinct methods for the collection of taxes. One is administrative collection by the IRS by means of levy and seizure. Under the Code, this method of collection must be triggered by an assessment, which, pursuant to Section 6303(a), is accompanied within 60 days by a notice and demand for payment.<sup>7</sup> The

party liabilities that were not subject to separate assessment, and accordingly, contrary to petitioner's contention (Br. 11-13), the fact that Section 6303 at that time did not provide for notice of assessment to such third parties is significant in determining its meaning in the Section 3505 liability context.

<sup>7</sup> "Notice and demand" under Section 6303(a) should not be confused with the "notice of deficiency" described in Section 6212 of the Code. A notice of deficiency is a pre-assessment document, applicable to income, gift, and estate taxes, that the IRS generally must provide taxpayers before it may assess or collect a "deficiency" in such taxes, *i.e.*, a liability greater than that shown on the taxpayer's return. See I.R.C. §§ 6211(a), 6213(a). The notice of deficiency gives the taxpayer the opportunity to petition the Tax Court to have his liability for the asserted deficiency redetermined. I.R.C. § 6214. If a notice of deficiency is sent and the taxpayer does not petition the Tax Court, or if he petitions and a Tax Court decision redetermining a deficiency has become final, the IRS then may assess the deficiency (see I.R.C. § 6213(a)) and send the taxpayer a notice and demand, *i.e.*, a bill, for those taxes. The notice-of-deficiency procedure has no application where a taxpayer has filed a tax return showing a liability, but has not fully paid that admitted liability. Such an unpaid tax is subject to immediate assessment, and the IRS may assess and proceed to collect any tax shown on a return. See I.R.C. § 6151(a). Moreover, the notice-of-deficiency procedure has no application to certain types of taxes, such as social security taxes, excise taxes, and withholding of income taxes. For

United States is also empowered to seek a judgment for any unpaid tax liability by bringing a civil action in district court. It is this second method that must be used to collect a Section 3505 liability (see, *e.g.*, H.R. Rep. 1884, *supra*, at 65-66), and it was, of course, this method that was employed against petitioner here. But the reasons for requiring the IRS to provide a notice of assessment have no relevance where a liability is sought to be collected by civil suit; such notice is necessary as a practical matter only when administrative collection is invoked. Hence, the Third Circuit's construction of Section 6303(a) not only gives effect to the complete text of the statute, but also represents the construction that gives effect to the rationale underlying the notice requirement.

1. Section 6203 of the Code provides that an assessment is made "by recording the liability of the taxpayer in the office of the Secretary." An assessment is simply "a bookkeeping notation \* \* \* made when the Secretary or his delegate establishes an account against the taxpayer on the tax rolls" (*Laing v. United States*, 423 U.S. 161, 170 n.13 (1976)), and it "consists of no more than the ascertainment of the amount due and the formal entry of that amount on the books of the secretary." *United States v. Dixieline Financial, Inc.*, 594 F.2d 1311, 1312 (9th Cir. 1979). While the assessment itself is thus a mere bookkeeping matter, the consequences that flow from the making of an assessment are quite significant. See generally M. Saltzman, *supra*, ¶ 10.01, at 10-2.

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those taxes, the IRS may immediately assess and collect any additional taxes for which it has determined that the taxpayer is liable beyond the amounts shown on its return.

Once a tax has been assessed, the IRS is empowered to collect the tax using various summary methods of collection not involving resort to the courts. See *United States v. Rodgers*, 461 U.S. 677, 682-683 (1983); *Bull v. United States*, 295 U.S. 247, 259-260 (1935); see generally McGregor & Davenport, *The Collection of Delinquent Federal Taxes*, 28 So. Cal. Tax Inst. 589 (1976). The assessment automatically creates a lien against the taxpayer's property. See I.R.C. §§ 6321, 6322. If the taxpayer fails to pay the tax within 10 days after notice and demand, the IRS may levy against any property the taxpayer owns or on which a lien exists, and it may then sell the seized property (I.R.C. §§ 6331, 6335). And the government may file notice of the tax lien created by the assessment to protect its interest in the taxpayer's property against competing interests. See I.R.C. § 6323.

With limited exceptions, Section 7421(a) of the Code bars suits to enjoin the assessment or collection of taxes. Accordingly, once an assessment has been made, the taxpayer ordinarily has no recourse if he wishes to dispute his liability except to pay the tax and sue for a refund.<sup>8</sup> And the taxpayer has no

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<sup>8</sup> If an assessment is improper because it has not been preceded by the issuance of a requisite notice of deficiency (see note 7, *supra*), the taxpayer may bring suit to enjoin summary collection pending government compliance with the statutory procedures. See I.R.C. §§ 6213(a), 7421(a); *Cool Fuel, Inc. v. Connett*, 685 F.2d 309, 313 (9th Cir. 1982). In addition, where the Commissioner is authorized to terminate the taxpayer's taxable year (I.R.C. § 6851) or to make jeopardy assessments (I.R.C. §§ 6861, 6862), the assessment is subject to judicial review under Section 7429. It is clear, however, that except in the extraordinary case where a taxpayer can demonstrate that "under no circumstances could the

power to prevent the IRS from levying against his property unless he promptly pays the tax. See generally *United States v. National Bank of Commerce*, No. 84-498 (June 26, 1985).

An assessment thus provides the IRS with powerful administrative tools that it may use to effect immediate collection from the taxpayer, without resort to the courts. Sections 6321 and 6331(a) of the Code, however, restrain the commencement of these collection measures by requiring the Commissioner to wait 10 days after giving the taxpayer "notice and demand" under Section 6303(a) before proceeding to levy on or seize his property. See I.R.C. § 6321 (providing that a tax lien arises if "any person liable to pay any tax neglects or refuses to pay the same *after demand*") (emphasis added); I.R.C. § 6331(a) (authorizing levy and distraint if "any person liable to pay any tax neglects or refuses to pay the same *within 10 days after notice and demand*") (emphasis added). The primary function served by the Section 6303(a) notice of assessment and demand for payment is thus to protect the taxpayer against unexpected seizure of his property. See *Pet. App. 12a; Macatee, Inc. v. United States*, 214 F.2d 717, 719 (5th Cir. 1954). Notice and demand permit him to make immediate payment (subject to later recovery in a refund suit) and thereby avoid embarrassment and other difficulties that may result from the recording of liens against, or the seizure of, his assets. Notice and demand also afford the taxpayer an op-

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Government ultimately prevail" (*Enochs v. Williams Packing Co.*, 370 U.S. 1, 7 (1976)), the taxpayer cannot restrain the collection of assessed taxes simply on the ground that he does not in fact owe the taxes. That question must be litigated in a refund suit.

portunity to bring an immediate suit to restrain collection, if there exist the limited circumstances under which such suits are permitted (see note 8, *supra*). Thus, Congress reasonably concluded that fairness to taxpayers requires that Section 6303(a) notice and demand be provided to persons against whom an assessment has been made before summary administrative collection methods can be invoked.

2. When the Commissioner does not resort to summary administrative collection methods, however, but rather requests the Justice Department to commence a civil suit, "notice and demand" under Section 6303(a) play no significant role in the tax-collection process. The government is empowered to bring a collection action to obtain a personal judgment against a taxpayer for a tax due. See I.R.C. § 7401 (providing that such action can be commenced only with the concurrence of the Commissioner and at the direction of the Attorney General); 28 U.S.C. 1396 (establishing venue for such action). The power to bring a collection suit exists independently of any statutory authorization; it is based simply on the government's common-law right to sue on a debt. See, e.g., *United States v. Chamberlin*, 219 U.S. 250, 261 (1911); *Dollar Savings Bank v. United States*, 86 U.S. (19 Wall.) 227, 239-240 (1874). In the words of Judge Friendly, "in 1791 an action of debt lay in England for the collection of taxes, [and] such an action has always lain in the federal courts even apart from statute." *Damsky v. Zavatt*, 289 F.2d 46, 51 (2d Cir. 1961).

This judicial action to collect a tax debt is independent of the administrative collection process. It has long been settled that the government's failure to assess taxes does not preclude it from exercising its right to sue the delinquent taxpayer for those taxes.

See, e.g., *King v. United States*, 99 U.S. 229, 233 (1878); *Dollar Savings Bank v. United States*, 86 U.S. (19 Wall.) at 240-241; *Macatee, Inc. v. United States*, 214 F.2d at 717. Indeed, the government's right to collect taxes without assessment is expressly recognized in Section 6501(a) of the Code, which establishes a three-year statute of limitations for bringing a "proceeding in court without assessment for the collection of such tax," a period that may be extended if an assessment is made. When a civil suit is brought without an assessment, however, summary collection procedures (such as levy and distraint) are not available. Accordingly, there is no particular need to notify the taxpayer of the amount of his tax liability in advance of such a suit, or to make a prior "demand for payment" upon him, since there is no possibility of nonjudicial seizure of his property against which he must be warned. Rather, just as is the case with any other lawsuit, the filing of the complaint provides all the notice that the taxpayer needs to protect his interests.

For the same reasons, it would make little sense to extend the Section 6303(a) notice requirement to third parties who might conceivably be held personally liable under Section 3505. The government can take action to collect that liability only by filing a civil suit; the lender under no circumstances can be subjected to the risk of summary collection procedures that attend an assessment. See, e.g., H.R. Rep. 1884, *supra*, at 65-66.<sup>9</sup> It is of course true that a

<sup>9</sup> Amicus American Bankers Association appears to take the position (Br. 13) that the Commissioner is empowered to make an assessment directly against a third-party lender for its Section 3505 liability. It is surprising that amicus takes this position for, if it were so, it would make collection of Section

lender whom the government seeks to hold liable under Section 3505 is entitled to "some device which serves the same function of providing notice to the defendant that the filing of a lawsuit would" (American Bankers Ass'n Amicus Br. 7). But that "device" is already in place; it is, somewhat truistically, the filing of the government's lawsuit. The notice specified in Section 6303(a) would not really serve this function at all, since it would not tell the third party whether or not the government actually intended to collect on its Section 3505 liability, nor would it tell the third party what the amount of its potential exposure was likely to be. In short, the Section 6303(a) notice is designed to serve the specific purpose of demanding payment from the party against whom the assessment is made, informing him that he may be subject to summary collection procedures if he fails to pay at once. The notice loses its utility when extended beyond that context.

3. Petitioner's contention that Section 6303(a) requires notice to third parties is further belied by the well-settled rule that the Commissioner's failure to notify a taxpayer of an assessment does not bar suit by the United States to collect that individual's delinquent taxes. Even in cases where the IRS as-

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3505 liabilities much easier. The Commissioner could simply make an assessment and levy on the funds of the presumably solvent bank; the government would then not need to go to the trouble of litigating a civil action in court. In fact, however, amicus's suggestion is plainly mistaken, as amicus First Alabama Bank points out (Br. 13 & n.7). There is simply no statutory authority for the Commissioner to assess a third-party lender for its Section 3505 liability. See pages 43-44, *infra*; *United States v. Dixieline Financial, Inc.*, 594 F.2d at 1313; but see *United States v. Messina Builders & Contractors Co.*, slip op. 11-12 & n.5.

sessed a tax but failed to provide the taxpayer with the notice and demand specified in Section 6303(a), the courts have held that this procedural error did not extinguish the taxpayer's liability or bar the United States from proceeding to collect that liability by a timely-filed civil suit. See *United States v. Erie Forge Co.*, 191 F.2d 627, 631 (3d Cir. 1951), cert. denied, 343 U.S. 930 (1952); *Jenkins v. Smith*, 99 F.2d 827, 828 (2d Cir. 1938). Those courts explained that an assessment, with its attendant notice requirement, is a prerequisite to the *administrative* collection process, so that the Commissioner's failure to give the taxpayer Section 6303(a) notice could well prevent the IRS from levying on the taxpayer's property. But an assessment—and a fortiori notice to the taxpayer of an assessment—"is immaterial in an action by the United States" because such a suit may be brought "‘upon the duty imposed by the statute alone,’" that is, upon the taxpayer's statutory obligation to pay his taxes. *Erie Forge*, 191 F.2d at 631 (quoting *Jenkins*, 99 F.2d at 828). Since the provision of Section 6303(a) notice to the taxpayer against whom the assessment is made is not a prerequisite to a civil suit to collect from him, it would be perverse to read into Section 6303(a) a congressional intent that the provision of such notice to a third party is a prerequisite to a civil suit to collect from that third party. Indeed, under the rule set forth in *Erie Forge* and *Jenkins*, even if Congress had established a third-party notice requirement in Section 6303(a), the Commissioner's failure to satisfy that requirement would not bar the United States from bringing a civil suit like this one, which is simply "an action on a debt to impose personal liability"

upon the lender (*Farmers-Peoples Bank v. United States*, 477 F.2d 752, 756 (6th Cir. 1973)).<sup>10</sup>

Petitioner does not dispute the correctness of the authorities just cited for the proposition that the government's failure to provide post-assessment notice and demand to a taxpayer is not a bar to a civil suit to collect the taxpayer's debt. Indeed, petitioner seems to acknowledge that the Code prior to 1954 did not require the government to provide notice of assessment to third parties (Pet. Br. 12-13). Petitioner contends, however, that this rule was altered by certain executive-branch reorganizational changes that were made in 1950 and incorporated into the 1954 Code.

Under the 1939 Code, the duty to provide taxpayers with "notice and demand" following an assessment was entrusted to Treasury Department officials called "collectors of internal revenue," who were in charge of administrative tax collection generally; civil actions to collect taxes (then as now) were commenced at the direction of the Attorney General upon request from the Commissioner. Internal Revenue Code of 1939, ch. 2, §§ 3655(a), 3740 and 3940-3978,

<sup>10</sup> The Eleventh Circuit has stated that the government has no inherent common law right to sue to collect Section 3505 liabilities because the debt it thereby seeks to collect "is a creature of statutory, not common law." *United States v. Merchants Nat'l Bank*, 772 F.2d at 1524 n.1; see also *United States v. Messina Builders & Contractors Co.*, slip op. 10-11. This statement completely misses the point. There is no question that liability under Section 3505 is a creature of statute, but so are tax liabilities generally; and there is no doubt that the government has a common law right to sue to collect taxes. It is the government's *right to sue* that is based on common law; it is quite irrelevant whether the *debt* sought to be collected in that suit is created by statute or by common law.

53 Stat. 446, 460, and 480-486. Petitioner views the decisions in *Erie Forge* and *Jenkins* as critically dependent upon this division of labor: the reason that civil suits were there permitted despite the absence of timely notice and demand, petitioner seems to say, is that the courts were reluctant to preclude action by the Attorney General and the Commissioner because of the collector's procedural default. Petitioner asserts (Br. 11-15) that this rationale disappeared in 1954, when Congress centralized in the hands of the Secretary of the Treasury *both* the power of administrative tax collection formerly exercised by tax collectors *and* the power to authorize the Attorney General to institute civil litigation. When Congress codified this reorganization and at the same time enacted a new version of Section 6303(a), petitioner concludes, the effect was to require the Secretary to issue a timely notice and demand to a third party as an absolute prerequisite to the commencement of a civil action against that person.

Petitioner's contention is multiply flawed, as the court of appeals explained in detail below (Pet. App. 13a-17a). First and foremost, the rationale of *Jenkins* and *Erie Forge* was not that the collector's procedural default could not be imputed to other government officials, but that the collector's default affected only the government's ability to collect the tax administratively, rather than eradicating the taxpayer's underlying duty to pay the tax. Since the taxpayer, notwithstanding the absence of notice and demand, continued to have a "legally enforceable liability" to pay the tax, the courts reasoned that the tax could be collected by other means at the government's disposal, such as a civil suit initiated by the Attorney General. See *Jenkins*, 99 F.2d at 828; *Erie*

*Forge*, 191 F.2d at 631. In short, it was not the identity of the particular government official charged with providing notice and demand, but the nature of the collection method sought to be invoked by the government, that those courts found dispositive.

In any event, the premise of petitioner's contention is that there was a legally significant shift of authority effected by Congress in 1954, and this premise is plainly erroneous. The two organizational changes that petitioner describes—the abolition of the position of tax collector and the vesting of the power to collect taxes administratively in the hands of the Secretary of the Treasury—were effected by Executive Orders in 1950 and 1952. See Reorg. Plan No. 26 of 1950, 15 Fed. Reg. 4935 (1950); Reorg. Plan No. 1 of 1952, 17 Fed. Reg. 2243 (1952). These were changes of form, not substance. Under the 1939 Code, all tax collection activities were under the "general superintendence" of the Commissioner, who in turn was under the direction of the Secretary (§ 3901(a)(1), 53 Stat. 477). Thus, even prior to the 1950-1952 reorganization, the Secretary was ultimately responsible both for administrative tax collection and for recommending the institution of civil litigation, and hence the 1954 Code made no substantive change in this regard. The legislative history makes it clear that the 1954 codification was not intended to change pre-existing notice requirements, since Congress specifically observed that Section 6303(a) contained only "two changes from existing law," neither of which is of any relevance here. See H.R. Rep. 1337, 83d Cong., 2d Sess. A405 (1954); S. Rep. 1622, 83d Cong., 2d Sess. 574 (1954); Pet. App. 15a & n.6. Accordingly, there is no basis for concluding that the 1954 enactment of Section 6303(a)

effected any substantive change with respect to the parties to whom notice must be given or with respect to the consequences of failure to provide such notice. It thus remains the law that the failure to provide Section 6303(a) notice and demand does not bar a civil tax-collection suit. See *Marvel v. United States*, 719 F.2d 1507, 1513-1514 (10th Cir. 1983); *Sherwood v. United States*, 246 F. Supp. 502, 507-508 (E.D. N.Y. 1965).

**C. Sending Third Parties A Copy Of The Notice Of Assessment Against The Employer Would Serve No Useful Purpose**

Petitioner cannot dispute that furnishing a copy of the notice of assessment to third parties would not serve the overriding purpose of the Section 6303(a) notice provision, namely, to demand immediate payment from the party against whom the assessment is made, thus giving that individual an opportunity to take steps to avoid summary collection procedures. Petitioner argues, however, that third parties will be unfairly prejudiced in other ways if they are not notified of the assessment against the employer. This argument does not withstand analysis.

1. Petitioner asserts (Br. 20-22, 26-27) that, unless third-party lenders receive a copy of the tax bill sent to the employer under Section 6303(a), they may be unaware of the possibility that the government might seek to hold them personally liable under Section 3505, and hence may unwittingly destroy records or take other steps that could prejudice their defense in the event that the government were eventually to bring suit against them. As the court of appeals explained (Pet. App. 17a-19a), the "scienter" standard contained in Section 3505 eliminates any

possibility of prejudice in this regard. That scienter standard ensures that a third party will not be subject to liability under Section 3505 unless it already has in its possession, at the time it advances funds to the employer, all relevant information that would be conveyed to it by a Section 6303(a) notice and demand.

The notice that petitioner seeks would not give third parties any indication of the likelihood that the government might actually bring a Section 3505 action against them. That datum is not within the contemplation of Section 6303(a); indeed, at the time a notice of assessment is mailed to the employer, the IRS typically would have no idea whether it would be likely to bring future suits against third parties. What the Section 6303(a) notice says is that an assessment has been made and that the subject of the assessment must pay the tax due. The relevant information that would be conveyed to a third party receiving a copy of this notice would be that the employer owes taxes (which is apparent from the face of the assessment notice) and perhaps that the government believes the third party to face possible exposure under Section 3505 (which it might deduce from the fact that a copy of the notice was sent to it).

In conveying this information, the Section 6303(a) notice would tell a third-party lender who runs a risk of Section 3505 liability nothing that he does not already know. Section 3505 establishes third-party liability only where the lender is himself paying net wages or where he has "actual notice or knowledge" that the employer will not or does not intend to pay withholding taxes (I.R.C. § 3505(a) and (b)). In either case, the lender is aware that withholding

taxes are not being paid and hence knows that the employer owes taxes. The lender, moreover, is presumed to be aware of the law and hence to know that entering into payroll-financing arrangements causes one to face possible exposure under Section 3505 if withholding taxes are not paid. Thus, any lender that is potentially subject to Section 3505 liability must already have in his possession all relevant knowledge that a Section 6303(a) notice would give him. Because such a lender "must have necessarily been intimately involved in the employer's failure to pay taxes" (*United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d at 1441)), the lender is fully capable of taking whatever steps he deems appropriate to preserve records of the payroll financing operation and otherwise to protect himself against the possibility of a future Section 3505 suit. Receiving a copy of the employer's tax bill would add no relevant facts to the sum of his knowledge and hence the failure to provide him with a copy of that notice would not prejudice him in any way.

Petitioner makes the related point that furnishing an employer's lenders with a copy of the Section 6303(a) notice would "allow the lender to evaluate its ongoing relationship with the borrower" so that it could "take steps to monitor the employer's payment of [withholding] taxes" or even "stop funding the employer completely" (Br. 24-25). Amicus American Bankers Association similarly argues (Br. 11) that the notice of assessment would supply a bank with "knowledge that the borrower is in dire financial straits" so that the bank "would be able to limit its losses on potentially bad loans." But the idea that Section 6303(a) could require the IRS to provide notice and demand to lenders in order to serve these objectives is quite odd. One would have thought that

it is the responsibility of the bank, not of the Internal Revenue Service, to monitor the financial condition of the bank's customers and to evaluate the profitability of a continued debtor-creditor relationship. There is absolutely no reason to suppose that Congress intended to require the IRS to spend public funds to relieve banks of the task of keeping abreast of their borrowers' financial condition.

To the contrary, the legislative history of Section 3505 demonstrates that "Congress envisioned a system in which third parties would take their potential liability under section 3505 into consideration at the time they entered into the transaction exposing them to liability under the statute" (Pet. App. 19a). For example, the committee reports on the 1966 legislation stated that "sureties can protect themselves against any losses attributable to withholding taxes by including this risk of liability in establishing their premiums, and lenders by their including the amounts in their loans and taking adequate security." H.R. Rep. 1884, *supra*, at 22; S. Rep. 1708, *supra*, at 23.<sup>11</sup> Congress plainly intended that third parties entering into lending arrangements that might bring them within the purview of Section 3505

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<sup>11</sup> Petitioner asserts (Br. 28-32) that the reports' statement to this effect related only to Congress's amendment of the Miller Act, 40 U.S.C. 270a(d), that was also a part of the 1966 legislation. Although the heading of the paragraph in which the statement occurs refers to the Miller Act, the statement is prefaced by the phrase "[i]n the cases discussed above," and the context makes it quite clear that this phrase refers to the immediately preceding discussion of Section 3505 liability. The committees apparently were referring both to the Miller Act and to Section 3505 in discussing how third parties could protect themselves against the new liability that was being imposed.

should accept, as an incident of the lending transaction, some responsibility for monitoring the payment of withholding taxes. Indeed, as the Third Circuit observed (Pet. App. 6a), Congress found that lenders who engage in net payroll financing "sit in essentially the same position vis-a-vis control over payroll and access to information as the employer itself." See H.R. Rep. 1884, *supra*, at 20; S. Rep. 1708, *supra*, at 21-22. Thus, Congress cannot have expected that third parties would have any need of the sort of notice provided by Section 6303(a), and Congress cannot have intended to burden the IRS with the duty of communicating with third-party lenders so as to relieve them of their monitoring responsibilities. For these reasons, the court of appeals correctly concluded that furnishing the third-party lender with a copy of the Section 6303(a) notice sent to the employer would merely add a "formalistic requirement for the imposition of section 3505 liability" that would "serve[] no useful purpose" (Pet. App. 18a).

2. Petitioner also contends (Br. 18-22) that a third party is prejudiced by its failure to receive a notice of the assessment against the employer because of the manner in which an assessment affects the statute of limitations applicable to collection suits. Section 6501(a) of the Code generally provides that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed \* \* \* and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period." Section 6502(a)(1) in turn generally provides that, if an assessment is timely made, "such tax may be collected by levy or by a proceeding in court \* \* \* begun \* \* \* within 6

years after the assessment of the tax."<sup>12</sup> Petitioner thus correctly states that an assessment of tax against the employer made on the last day of the three-year limitations period would have the effect of increasing the overall statute of limitations from three years to nine years. Petitioner asserts that it is unfair to provide notice to the employer of this limitations-lengthening event without also providing notice to third parties potentially liable under Section 3505. See Pet. Br. 6, 16-22, 28.

Petitioner's contention is without merit. Although six years after assessment may seem a long time, that is the period that is routinely available to the Commissioner to collect taxes from employers (and from taxpayers generally) where, as will typically be the case, the Commissioner has assessed the taxes in timely fashion. As we have noted above, a third-party lender will run a risk of Section 3505 liability only if it has actual knowledge that the employer's withholding taxes are not being paid. Any prudent lender, moreover, necessarily must assume that the Commissioner will not let the three-year statute of limitations run against the government, but rather will timely assess the unpaid withholding taxes in order to protect the revenue. Lenders who engage in net payroll financing are accordingly on notice to take whatever steps they deem necessary to protect evidence and otherwise preserve their defenses for a period of nine years from the date on which the withholding taxes were due.<sup>13</sup>

<sup>12</sup> Section 6503 provides for the suspension of the running of the statute of limitations in certain specified circumstances.

<sup>13</sup> If a lender for some reason believes it absolutely essential to be notified that a tax assessment has been made against one of its borrowers, the lender can take various steps to

Equally erroneous is petitioner's assertion (Br. 19) that our interpretation of Section 6303(a), when coupled with the applicable statute-of-limitations rules, "results in less procedural protection to a third party \* \* \* than to the employer." In actuality, third parties are afforded considerably *more* procedural protection than employers by virtue of the fact that the government is not authorized to assess Section 3505 liabilities. Because the IRS in the absence of an assessment cannot resort to summary collection procedures, the lender, unlike the employer, is assured that he will not be deprived of property to satisfy the asserted Section 3505 obligation without a judicial finding of liability. In a Section 3505 action to collect from a lender, moreover, the government bears the burden of proving the elements necessary to establish liability on the lender's part. See, e.g., *United States v. Intercontinental Industries, Inc.*, 635 F.2d 1215, 1219-1220 (6th Cir. 1980); H.R. Rep. 1884, *supra*, at 21; S. Rep. 1708, *supra*, at 23. By contrast, in a collection or refund suit involving the taxpayer against whom the tax is assessed, the assessment is deemed *prima facie* correct and the taxpayer bears the burden of proving it erroneous. See, e.g., *United States v. Janis*, 428 U.S. 433, 440-441 (1976). For these reasons, our interpretation of the statute does not place the lender in a worse

obtain that information. The lender, for example, can draft its lending agreement to require the borrower to notify it upon receipt of any bill for unpaid taxes. If the lender does not believe that it can trust the borrower himself to provide this information, it can require the borrower to execute a power of attorney (IRS Form 2848) or a tax information authorization (IRS Form 2848-D) directing the IRS to mail copies of tax notices and other written communications concerning the borrower to the bank.

position than the employer nor does it otherwise result in unfairness to third parties.<sup>14</sup>

3. Amicus First Alabama Bank (Br. 20-25) appears to proffer a further argument on the statute-of-limitations front, one addressed to the proper construction of Section 6502(a) rather than of Section 6303(a). Amicus concedes in this connection (Br. 17 n.9) that the Commissioner's failure to provide Section 6303(a) notice to a third-party lender would not bar a Section 3505 suit against the lender if the suit were brought within the three-year limitations period specified in Section 6501(a). Amicus goes on to argue, however, that Section 6502(a), which permits a civil collection suit to be commenced within six years of assessment, should not be effective against a lender that has not received notice of the assessment. Because the instant suit, on the authority of Section 6502(a), was commenced within six years

<sup>14</sup> It is worth noting that the three-year statute of limitations on assessment of taxes can be extended without the taxpayer's consent or knowledge for various reasons, and that taxpayers cannot be heard to complain of unfairness on this account because their knowledge of the relevant facts puts them on notice to preserve their defenses accordingly. If a taxpayer's return contains a 25% omission from gross income, for example, the three-year statute of limitations on assessment is extended to six years (I.R.C. § 6501(e)(1)(A)), with the Commissioner being allowed another six years to collect taxes properly assessed within that time (I.R.C. § 6502(a)). If the taxpayer fails to file a return, or if any entry on his return is tainted with fraud, his tax may be assessed, or a proceeding in court may be begun without assessment, "at any time" (I.R.C. § 6501(c)(1) and (3)). In all these situations, the taxpayer is presumed to be aware of the exposure to which he has subjected himself by virtue of his conduct, and he accordingly acts at his peril in destroying documents or otherwise failing to preserve relevant evidence.

of the assessments against Pennmount but more than three years after Pennmount's employment tax returns were filed, and because petitioner did not receive a copy of the notice of assessment sent to Pennmount, amicus contends (Br. 20-25) that the three-year statute of limitations of Section 6501(a) bars this action.

We note at the outset that amicus's statute-of-limitations argument is not properly before this Court. The question on which the Court granted review is whether the lender's receipt of a Section 6303(a) notice of assessment is a prerequisite to the government's maintenance of a Section 3505 suit to collect the lender's liability. That question depends upon the proper construction of Section 6303(a) and does not turn on the timing of the government's action. Amicus's statute-of-limitations argument has nothing whatever to do with Section 6303(a), but relates rather to the proper construction of Section 6502(a). A statute-of-limitations defense, moreover, is not available to petitioner here because petitioner did not raise that defense in its answer, as Rule 8(c) of the Federal Rules of Civil Procedure requires, or at any other time in the district court. See Pet. App. 46a-49a. Petitioner's failure to invoke the statute-of-limitations defense in a timely fashion constitutes a waiver that precludes petitioner from raising the defense on appeal. See, e.g., *Perry v. O'Donnell*, 749 F.2d 1346, 1353 (9th Cir. 1984); *Moore v. Tangipahoa Parish School Board*, 594 F.2d 489, 495 (5th Cir. 1979). A fortiori that defense cannot now be raised by an amicus curiae.

In any event, amicus's statute-of-limitations contention is without merit. As amicus recognizes, the Code sets forth no explicit statute of limitations for

Section 3505 suits. In the absence of an explicit statute of limitations, Section 3505 actions might appear at first blush to fall within the general rule that the government is not subject to *any* limitations period unless Congress has specifically provided one. See *Guaranty Trust Co. v. United States*, 304 U.S. 126, 132-133 (1938); *Badaracco v. Commissioner*, 464 U.S. 386, 392 (1984) (statutes of limitations barring the collection of taxes are strictly construed in favor of the government). In *United States v. Updike*, 281 U.S. 489 (1930), however, this Court held that a suit to collect a transferee's third-party liability was governed by the statute of limitations applicable to a suit to collect the taxes from the transferor. The Court explained (*id.* at 493-496) that the congressional purposes underlying both the establishment of the statute of limitations and the imposition of third-party liability are best fulfilled by allowing the government the same period for collection of the third party's liability as applies to the underlying liability of the taxpayer. Application of that principle here would indicate that a suit to collect a lender's Section 3505 liability should be subject to the limitations periods established by the Code for suits against the delinquent employer—that is, six years from the date of the assessment when the assessment is timely made. See I.R.C. §§ 6501(a) and 6502(a)(1); Treas. Reg. § 31.3505-1(d)(1). Accord, e.g., *United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d at 1441; *United States v. Associates Commercial Corp.*, 721 F.2d at 1097-1098.

This implicit limitation on the time within which Section 3505 suits can be brought is purely derivative of the explicit limitation placed on suits against

the employer. There is, therefore, no conceivable basis for amicus's contention that, because petitioner did not receive a Section 6303(a) notice, it should be subject to a *shorter* statute of limitations than is the employer. Either Section 3505 collection suits are governed by no limitations period at all, or they are governed derivatively by the limitations period applicable to suits against employers, in which case the latter period and the Section 3505 period must be congruent. It is an impermissible form of bootstrapping to begin with no statute of limitations at all, proceed to find a derivative statute of limitations, and then use that derivative period as a springboard to argue for a still-shorter statute of limitations.<sup>15</sup>

Even if there were some basis for amicus's assumption that the Section 6502(a) limitations period is directly applicable to suits against a lender, rather than derivatively applicable through congruence with suits against the employer, there would still be no reason to link the statute of limitations to the receipt or non-receipt of a Section 6303(a) notice. The terms of Section 6502(a) make it quite clear that it is *timely assessment*, not *timely notice* of assessment, that brings the six-year period for collections into

<sup>15</sup> We note incidentally that acceptance of amicus's contention that suits to collect Section 3505 liabilities are subject to a shorter limitations period than suits to collect delinquent withholding taxes from the employer would not necessarily be to the benefit of lenders. If amicus's statute-of-limitations argument were correct, the government in some instances would have little choice but to protect itself by trying to collect first from the lender before exhausting collection efforts with respect to the employer, which is contrary to the Commissioner's present practice. See *United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d at 1441; *United States v. Associates Commercial Corp.*, 721 F.2d at 1098.

play. See I.R.C. § 6502(a) (“[w]here the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected \* \* \* within 6 years after the assessment”). Once a timely assessment is made against the employer, in other words, Section 6502(a) gives the government six years to bring a collection suit against the employer, even if the government for some reason failed to give notice of the assessment to him. A fortiori, the government has the same six years to bring suit against a third-party lender irrespective of whether the lender received a copy of that notice.

**D. Requiring The Commissioner To Send Section 6303(a) Notice To Lenders As A Prerequisite To A Suit To Collect Their Section 3505 Liabilities Finds No Support In The Legislative History Of Section 3505 And Would Destroy The Practical Utility Of That Provision**

1. The legislative history of Section 3505 and the policies underlying it confirm the conclusion derived from an examination of Section 6303(a) alone—namely, that Congress did not intend that the Commissioner be required to furnish third parties with notice and demand under Section 6303(a) as a prerequisite to suit under Section 3505. There is nothing in either the language or history of Section 3505 to suggest that Congress intended a lender's liability to hinge on whether it had received notice of the sort described in Section 6303(a). Indeed, the mechanism that Congress prescribed for collecting the lender's liability clearly suggests the reverse. Congress did not provide the IRS with authority to make an assessment against a third party for Section 3505 liability. Instead, Congress restricted the government to collec-

tion "by appropriate civil proceeding." H.R. Rep. 1884, *supra*, at 66.

This treatment stands in sharp contrast to the mechanism prescribed for collecting certain other third-party liabilities under the Code. Congress has provided, for example, that the liability of certain transferees (I.R.C. § 6901(a)) and of responsible officers (I.R.C. § 6672(a)) "shall be assessed and collected in the same manner as [the] taxes" of the taxpayer itself, thereby empowering the Commissioner to use summary collection procedures following notice and demand. See I.R.C. §§ 6671(a), § 6901(a). Having purposefully established a procedural framework that does not require—or even permit—a separate assessment to be made against the third party (see *United States v. First Nat'l Bank*, 652 F.2d 882, 889 (9th Cir. 1981); *United States v. Dixieline Financial, Inc.*, 594 F.2d at 1313; *United States v. Marine Midland Bank*, 544 F. Supp. 268, 270 (W.D. N.Y. 1982)), Congress is most unlikely to have contemplated extending to third parties the requirement of notice under Section 6303(a). That notice is designed to protect the taxpayer against summary collection procedures and has never been considered a prerequisite to the institution of a civil collection suit (see pages 21-29, *supra*).<sup>16</sup>

<sup>16</sup> Petitioner errs in characterizing our position as a contention that Section 3505 creates an "exception" (Pet. Br. 10) to Section 6303(a). On the contrary, as explained in detail above (pages 13-32, *supra*), we submit that Section 6303(a) has never imposed an obligation on the government to send a copy of the taxpayer's notice of assessment to *any* third party, regardless what provision of the Code the third party's liability might rest upon. We note here only that Section 3505 itself imposes no such obligation and provides no reason to give Section 6303(a) a different construction.

2. The fact that Congress did not intend to make Section 6303(a) notice to lenders a prerequisite to a civil suit under Section 3505 is confirmed by examining the practical effect that such a requirement would have. The court of appeals below correctly concluded (apparently without intending an oxymoron) that a notice requirement would render Section 3505 "a substantial nullity" (Pet. App. 21a).

When the Commissioner makes an assessment of unpaid withholding taxes, he ordinarily will have no way of knowing whether the delinquent employer has borrowed money from a third party under circumstances that might render the latter liable under Section 3505. There is no indication on the face of the employment tax return who the employer's creditors might be, much less any indication whether such creditors might themselves have paid net wages (I.R.C. § 3505(a)) or have "actual \* \* \* knowledge" (I.R.C. § 3505(b)) of the employer's withholding tax delinquency.<sup>17</sup>

<sup>17</sup> The suggestion of amici American Bankers Association (Br. 12) and First Alabama Bank (Br. 16 n.8) that the IRS could solve these practical problems by modifying the employment tax return to require the employer to identify its creditors is wholly unrealistic. To begin with, the vast bulk of lending arrangements expose the lender to no conceivable risk of liability under Section 3505. Obtaining a list of *all* lenders and then giving them notice of the assessment against the employer is not only grossly overinclusive, but could result in severe financial burdens on employers by impairing their access to the credit markets. Nor would it be feasible for the IRS to require the employer to disclose the names of only those lenders who might be liable under Section 3505. The determination that a lender is liable under Section 3505 may present complex factual and legal issues, issues that the employer is obviously in no position to resolve. Moreover, an employer who is not paying his employment taxes may well

Moreover, the Commissioner cannot reasonably be expected, at the time he makes the assessment against the employer, affirmatively to undertake to identify the lenders who may have potential liability for the unpaid withholding taxes. The IRS during 1984 received about 19 million quarterly employment tax returns, almost six million of which were accompanied by only partial payment or by no payment at all.<sup>18</sup> In order to protect the revenue, the Commissioner typically assesses such delinquent taxes against the employer within a month or two after receiving the return. As the court of appeals observed (Pet. App. 20a), it would obviously "impose a prohibitory investigative burden on the government" to require the Commissioner, within 60 days of making those six million assessments, to identify and notify all lenders who might be personally liable for the taxes thus assessed.

Even if such investigations were realistically possible, they would entail a tremendous waste of resources. Like any creditor, the Commissioner ordinarily tries to collect delinquent withholding taxes first from the employer itself by sending the employer

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be in desperate financial shape, and he cannot be depended upon to disclose the identity of the lenders who are supplying him with sorely needed funds. Finally, if failure to provide Section 6303(a) notice were a bar to collection of Section 3505 liability, keying that notice to information contained in employer returns would enable the employer to insulate his lenders from liability simply by omitting their names from his tax returns. In short, amici's suggestion, which resembles a suggestion recently advanced by the Eighth Circuit (*United States v. Messina Builders & Contractors Co.*, slip op. 11), is completely unsatisfactory.

<sup>18</sup> These statistics have been provided to us by the IRS and are based on information in its files.

a series of bills (i.e., notice and demand under Section 6303(a)) for the unpaid taxes. See M. Saltzman, *supra*, ¶ 14.03, at 14-11 *et seq.* If collection efforts against the employer fail,<sup>19</sup> it is the Commissioner's usual practice to try to collect under Section 6672 from the employer's responsible persons. Only after those avenues have been investigated does the Commissioner normally explore the possibility of collection from lenders.<sup>20</sup> Indeed, the IRS estimates that Section 3505 comes into play in about only one case for every 5,000 withholding-tax delinquencies. Because lenders in the vast majority of cases will never be called upon to pay the delinquent taxes, it would be exceedingly inefficient and wasteful for the IRS to go to the expense of identifying and notifying them at the very outset of the collection process—a step that would needlessly embarrass employers and convey no useful information to lenders in any event.

Petitioner's suggestions for avoiding the formidable practical obstacles to giving Section 6303(a) notice to lenders are wholly unsatisfactory. The idea (Pet. Br. 23) that the IRS should delay making an assessment against the employer-taxpayer for up to three years, instead of making the assessment within a month or two of receiving the employer's return as

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<sup>19</sup> In most cases, collection is achieved without the need to take any steps other than sending notices to the employer. In 1984, for example, only about 1.1 million of the 6 million employment tax returns involving delinquencies gave rise to the issuance of "taxpayer delinquency accounts," which are issued after attempts to collect by sending notices to the taxpayer fail.

<sup>20</sup> There is nothing in the Code, however, that requires the Commissioner to try to collect the taxes from the employer and from the responsible persons under Section 6672 before pursuing lenders under Section 3505. Cf. note 15, *supra*.

is the Commissioner's current practice, would constitute a rather clear breach of the Commissioner's duty to protect the public fisc. As the court of appeals correctly recognized (Pet. App. 21a), such a delay in making the assessment would "seriously jeopardize the government's interest in collecting the taxes from the employer" because it would "enable other creditors to obtain prior liens against the employer's property."<sup>21</sup>

Equally flawed is the alternative suggestion of petitioner (Br. 25) and of amicus American Bankers Association (Br. 13) that the IRS should make its usual prompt assessment against the employer (without notice to lenders) and then make a "supplemental assessment" against the employer (with notice to lenders) under Section 6204(a) within three years after the return is filed. See also *United States v. Messina Buildings & Contractors Co.*, slip op. 12, where the same suggestion is advanced. Petitioner and amicus apparently offer this suggestion on the theory that, in the interim between the initial and supplemental assessments, the IRS would have enough time to undertake an investigation to learn the identities of third parties potentially subject to Section 3505 liability. This suggestion, of course, is inconsistent with petitioner's basic argument that Section 6303 (a) demands notice to third parties of an assessment against the employer within 60 days of making that assessment. Moreover, it is doubtful that petitioner's suggestion could be effectuated under existing law.

<sup>21</sup> Even if the amount of the withholding taxes were eventually recovered from the lender under Section 3505, the Treasury would still lose funds under petitioner's proposed procedure because delinquencies in the employer's portion of the social security tax can be collected only from the employer.

Section 6204(a) allows the Secretary to make a supplemental assessment only when "it is ascertained that any assessment is imperfect or incomplete in any material respect." This provision would not appear to be applicable where the only defect alleged is that a copy of the notice of assessment was not sent to a third party.

In sum, the practical effect of requiring the sort of notice sought by petitioner would be to eviscerate Section 3505. It is inconceivable that Congress, in enacting this provision to eradicate the practice of net payroll financing, would at the same time have incorporated a notice requirement that would so substantially weaken the statute as to ensure that the practice would continue unabated. The conclusion is inescapable that receipt of Section 6303(a) notice to an employer is not a prerequisite to a civil suit against a third party lender to collect a Section 3505 liability.

#### CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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